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WORKING PAPER

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OFFICE OF REPORTS AND ESTIMATES, CIA
FAR EAST/PACIFIC BRANCH

INTELLIGENCE HIGHLIGHTS NO. 50
4 May - 10 May 1949

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

On the international scene, the US may be obliged to exercise its veto powers in the Far Eastern Commission in order to block an Australian move of which SCAP disapproves (p. 2); the Chinese Communists have shown interest in the reestablishment of trade between Japan and North China (p. 2); and the UK has decided to extend substantial financial assistance to Burma (p. 3).

SCAP is sponsoring a program of increased international responsibilities for Japan, primarily in the hopes of boosting trade (p. 4).

The issue of US troop withdrawal from the Republic of Korea has assumed increased seriousness as a result of recent local developments (p. 5).

Chinese Communist forces, driving rapidly south of the Yangtze, have not yet attacked isolated Shanghai or outflanked Hankow (p. 5) and the National Government is still split into two camps despite the appearance of solidarity resulting from "Acting President" LI's return to Canton (p. 7). Shanghai, meanwhile, faces the prospect of grave internal disorder before the arrival of the Communists and the still less palatable possibility of being "scorched" in a Nationalist "defense to the last" (p. 6).

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The Batavia agreement on restoration of the Republic to Jogjakarta, while representing a considerable improvement in Dutch-Republican relations, still leaves many problems to be settled in Indonesia (p. 9).

The recent ousting of Avelino as chairman of the Philippine Liberal Party will be followed by competing conventions of the Avelinista and Quirinista factions, thus formalizing the split in Liberal ranks (p. 9).

The marginal notations used in succeeding sections of this Weekly ("A", "B", or "C") indicate the importance of the items in R/TE opinion with "A" representing the most important.

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

US may exercise veto in FEC — Australia's intended introduction of a policy "B" proposal before the Far Eastern Commission, extending trade union bargaining rights to Japanese government employees, may bring a US veto. The Australian action, taken in cognizance of the situation created by the Japanese Government's SCAP-approved denial of union rights to civil servants, is supported by Commonwealth and other countries in the FEC. A US veto can be expected to antagonize these countries, already inclined to see a revival of Japanese totalitarianism in legislation which restricts civil liberties.

General MacArthur reports that the present Japanese government probably would not accede voluntarily to the changes mandatory under the Australian proposal. He believes that reversal of the present US stand would involve a threat to the US position in Japan and views with special alarm the extension of collective bargaining rights to workers in the Communist-dominated communications field, thus subjecting Japanese internal security forces to a possible communications breakdown. MacArthur believes, further, that a US reversal would strengthen the Communist position in Japan. In consequence, he urges firm adherence to the present position and use of the veto if necessary.

Chinese Communists open Japan trade question — The Ministry of Industry and Commerce (MIC) in Communist-held Tientsin has recently initiated attempts "B" to open trade between North China and Japan. The MIC approached the US Consulate to find out whether or not SCAP would permit such trade with North China, stating that 100,000 tons each of coal and salt were available in exchange for Japanese machinery and other items. In addition, a US firm has been commissioned by the MIC to arrange trade with Japan on the basis of barter and/or link exchange. The large volume of goods which could be profitably exchanged by both countries and the bulk nature of North China's commodities — coal, iron ore and salt — whose commercially most feasible market is Japan, are strong pressures on North China to trade with Japan.

These official overtures for the revival of Japanese trade might well be an implementation of recent Chinese Communist top-level policy statements that "the foremost work" of the Communists now is "rehabilitation and development of industry", and that this "work" requires exchange of "agricultural products.....for machinery from abroad." YAO Yi-lin, Minister of Industry and Commerce, is said to have claimed that extremist lower-level Communists have "complicated the situation", but that from now on the moderate industrial policies recently announced by the CCP's Central Committee will be carried out. YAO reportedly is very anxious to restore

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China's prewar trade levels with the West, particularly the US, and Japan.

This Communist approach to the US Consulate and the US firm, possibly indicates that the Communists may be changing their attitude toward foreign trade; supplanting reluctance and indecision with cooperation and encouragement. If this change occurs, and if SCAP and Western Powers cooperate, Communist China's commerce may be expected to increase many times over that of the last few months and probably will exceed the volume attained during the recent Nationalist regime.

UK extends loan to Burma — The UK has decided to extend immediate financial assistance — to the amount of several million pounds — on a short-term basis to the near-bankrupt Burmese Government, primarily to finance Burma's rice crop and defray budgetary deficits. Although no final agreement has been reached by the two governments, the British Embassy in Rangoon has recommended a technique whereby a Sterling loan, blocked in London and controlled by the UK, would be advanced as currency security and issued to Burma in rupees. It seems likely that this plan, or a similar one, will be adopted.

"B"

The impending loan has been jubilantly hailed in Burma as a "spontaneous one without any strings attached." The British decision, however, will include conditions which will be imposed in a manner designed to avoid offending Burmese sensibilities. The British action is motivated largely by the desire to develop stability, arrest the spread of Communism, and to prevent the collapse of a government at least somewhat favorably disposed to the extensive British interests in Burma.

While financial assistance will serve the British purpose by easing the Burmese Government's desperate financial position, raising British prestige in the eyes of the Burmese Government and perhaps making the Government more receptive to British "suggestions", the basic problems remain to be solved. Burma will continue to be a financial "rat hole" until production is revived and such economic rehabilitation continues to depend upon the restoration of law and order. The British may be expected to exert discreet pressure on the Burmese, using financial aid as a lever. Remedial actions, such as coming to terms with the dissident Karens and possibly the Peoples Volunteer Organization, are certain to be among the British suggestions. Although the British approach contains the elements which could lead to a gradual improvement of the chaotic Burmese situation, the situation has deteriorated to such an extent that the prospects of its achieving any more than limited success are not bright.

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Steps towards resumption of international responsibilities--After a lapse "B" of almost four years, an approach has been made towards Japan's resumption of international contacts. The U.S. feels that the peace treaty is delayed indefinitely and international rights continue to be denied the Japanese through no fault of their own. Even partial international recognition, in contrast, would promote Japanese trade and thus alleviate the US financial burden.

The most publicized attempt to date to secure acknowledgement of a new international status is the effort to obtain official recognition for a Japanese delegation to the 18 May International Telecommunications Union (ITU) Conference at Paris. The US position has been that Japanese adherence to the ITU convention, with SCAP approval and in accordance with terms of a decision reached at the ITU Atlantic City Conference, is fully legal since the ITU Secretary General has accepted Japan's accession and has so informed member states. France, the conference's host nation, holds that Japan's accession must be approved by the FEC member nations and that without this approval Japanese may attend only as technical advisors to the SCAP observers. SCAP has authorized a Japanese delegation to obtain French visas in order to request official admission from the conference itself on the grounds that the French position is illegal. SCAP feels that the Japanese delegation, in the event of failure to obtain admission, should not take the position of technical advisors, as acceptance of anything less than official status would prejudice the US position relative to Japanese membership in ITU.

SCAP is now studying the question of resumption of international broadcasting from Japan. Successful accomplishment of this would facilitate 1) renewal of normal international responsibilities, and 2) rehabilitation of this means of communication while SCAP can exercise supervision. A further US step towards reentry of Japan into the family of nations was the attempt to obtain agreement to "most favored nation" treatment at the GATT (General Agreement on Tariffs and Trade) Conference at Annecy, France. UK refusal to grant "most favored nation" treatment forced the US to drop the proposal for the present.

On 21 April the US brought up in FEC a proposal to give Japan permission, subject to SCAP discretion and continued control, to participate in such international relationships and accords as it may be invited to enter. The reason for advancing this proposal is to encourage the development in Japan of respect for the rights of other nations and to facilitate the progressive resumption of its normal international responsibilities. US diplomatic officials have been directed to approach the foreign offices of all FEC nations, except the USSR, to obtain support for the proposal by pointing out not only the benefits to Japanese trade but also the necessity of promoting in Japan friendly relationships with non-Communist powers.

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KOREA

Withdrawal negotiations stalled--Ambassador Muccio in Seoul has not yet "A" been able to obtain President Rhee's concurrence for the early withdrawal of US occupation troops (see B/TE Intelligence Digest No. 5). Muccio still feels that Rhee's support for the early withdrawal date can be obtained, however, if the US will equip the Korean Coast Guard and Air Force, to the extent recommended by Muccio on several instances since January 1949.

The past week's developments have seriously complicated Muccio's problem. Rhee has pled for US guarantees of Korea's defense and independence and, at the same time, initiated a press campaign blaming the Republic's present plight on the US and claiming that the US should not and must not withdraw its troops unless Korea is given an "adequate" supply of weapons and a guarantee of "all-out American military aid" in the event of attack. Rhee's present publicity campaign apparently is being handled in Seoul by Robert T. Oliver - one of Rhee's circle of American friends and advisors during the war. Having stated this position so clearly to the press, Rhee will find it difficult to justify any subsequent support of US troop withdrawal unless he can simultaneously announce receipt of such strong US guarantees as he has requested.

Much graver obstacles in the way of Rhee's concurrence on withdrawal, however, were first, the outbreak of two major border clashes on 3 May, involving several hundred men on each side, and second, the 5 May defection of elements of two battalions of the Korean Army to northern Korea. Although the border incidents may well have been instigated by Rhee's troops, he will use them to underline his claim that more arms and equipment are essential for border defense. The desertion will further undermine the Republic's confidence in the ability of its security forces to resist Communist pressure and will make the rightists increase their pressure on Rhee to delay USAFIK's withdrawal.

CHINA

Communist military machine rolls on--Communist military forces south "A" of the Yangtze--reportedly 16 armies of CHEN Yi and 7 armies of CHEN Kung--pressed southeast toward the Chekiang-Kiangsi railway this week and, according to late reports, took control of at least 150 miles of this vital line. Although no direct drive on by-passed Shanghai has materialized to date, the fall of Hangchow and Kashing have completely isolated the city from the hinterland. The only surface route out of Shanghai now is the Whangpoo river and Communist advance elements are within 10 miles of Woosung, at the river's mouth. Despite Shanghai Commander TANG En-po's statements that he will defend Shanghai to the last, he has admitted to US officials that he cannot hold the city for long.

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It appears likely therefore, that TANG is in the process of evacuating his regular troops and that the Communists will try to block his escape route by taking Woosung.

To the west, the forces of CHEN Kung are reported moving on Nanchang in a two-pronged drive from the north and the southeast. Simultaneously, another CHEN Kung column is said to be moving west from the Kiukiang area to cut the Hankow-Changsha railroad.

In the Hankow sector, three additional armies of CHEN Kung plus 3 armies of LIN Piao are reportedly poised in an arc to the north of the Yangtze river port. PAI Chung-hsi therefore, must now evacuate Hankow or be encircled and cut off from his Kwangsi retreat. If PAI chooses to stay (and he admittedly cannot withstand a major Communist attack) he must either surrender or make a "deal." PAI's most probable line of action appears to be withdrawal of his better troops to Kwangsi and a "face-saving" token defense of the Wuhan sector by a small remaining force.

By-passed Shanghai faces grave problems--Despite a general desire "B" for an early, peaceful transfer of authority to the Communists, the people of Shanghai may experience a protracted and distressing ordeal prior to Communist occupation. The economic situation is already grave and will greatly worsen due to lack of money and commodities, disruption of normal economic activity and mounting unemployment. General TANG En-po has resorted to harsh measures such as forcible removal of part of the population and large-scale seizure of private property and further terroristic policies are probably in store for both Chinese and foreign residents. While some of these measures are justifiable military precautions, TANG is probably setting the stage for a shake-down deluxe; his price for not defending Shanghai. This coercive military rule, combined with severe economic hardships, probably will lead to formidable disorder.

Moreover, Shanghai may suffer as a result of Nationalist defense plans dictated by CHIANG Kai-shek, who has been in the city covertly directing affairs since late April. Despite military weakness, CHIANG may attempt to carry out a program of resistance and destruction. Besides directing military preparations, he reportedly has attempted to boost morale by promising his commanders additional US aid and by telling his officers that World War III will begin within six months. Although the resistance effort cannot be very effective, attempts to deprive the Communists of Shanghai's material and administrative resources may prove more successful. There is a general belief among foreign residents and others that the defenders plan destruction of the utilities and major industries, with serious consequences for foreign and Chinese business interests. Meanwhile, through CHIANG's influence, labor boss TU Yueh-sheng, top bankers K. P. CHEN, LI Ming, CHANG Kia-ngan and other prominent leaders as well as hundreds of business employees have left the city. Labor boss YANG Hu, former peace delegate W. W. YEN and others thus far

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have failed to go. Some observers believe that CHIANG's program may include adoption of a scorched earth policy and attacks on foreign interests in an effort to involve the Western Powers.

If carried out, these various measures might delay the Communist occupation, salvage some resources for the Nationalists and leave grave problems confronting the Communists. Possibly in CHIANG's mind the spectacle of a scorched Shanghai would furnish dramatic evidence of his struggle against international Communism, indicate to foreign powers the need for further aid and be an object-lesson to those powers whose nationals might lose lives and property. In any event, uncertain regarding actual Nationalist intentions and Communist plans renders impossible any accurate prediction on the exact character and duration of Shanghai's ordeal.

"Acting President" LI Rejoins Government--LI Tsung-jen's decision to leave Kwangsi and rejoin the Government in Canton indicates that a temporary working agreement with CHIANG Kai-shek probably has been reached. In consequence, the National Government, almost devoid of leadership since the fall of Nanking, now presents a facade of unity and leadership. Despite LI's continued protestations that he would resume active leadership only if CHIANG no longer exerted separate authority, it is doubtful whether any concrete solution to this problem has been reached.

While LI claims the support of Canton generals CHANG Fa-kwei, HSUEH Yueh and YU Han-mo, and hopes to have US moral support in attempting to replace Governor CHEN Cheng in Taiwan, it is doubtful whether he has all the support he claims or is able to organize an effective bloc. He probably has received little more than general assurances of non-interference from CHIANG, who still controls the bulk of the Nationalist financial resources, a fairly large body of troops and many Kuomintang leaders. CHIANG seems determined to conserve his strength for a last-ditch stand on the Foochow-Amoy-Taiwan triangle in the hope that he can survive until the outbreak of World War III. With LI and CHIANG competing for support of various factions, the National Government will probably function with only a semblance of leadership as it continues its disintegration.

Communists consolidate in Dairen--Since soon after V-J Day, Dairen has been governed by a "Kwantung Administration" made up of local Chinese, ostensibly non-Communists but under the Communist thumb. The "Kwantung Administration" has publicly claimed to be distinct from Communist China. In recent weeks, however, the Chinese Communist Party (CCP) has become increasingly prominent in Dairen.

Late in March, the non-Communist Mayor of Dairen took a "long leave of absence," and a CCP member was named Acting Mayor. At an April conference in Dairen, the "CCP in Port Arthur-Dairen" formally proclaimed its existence and announced its connection with the Northeast Bureau of the CCP. At the same conference, the CCP Regional Secretary for Dairen

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attributed the Party's success in Dairen to the assistance of the Soviet Army, and acclaimed the Sino-Soviet Treaty of 1945 for "preventing imperialist aggression." Subsequently, the CCP press has repeatedly endorsed the Sino-Soviet Treaty.

On 21 April, the non-Communist Chairman of the Kwantung Administration resigned. A hastily convened "People's Representative Conference" met on 27 April and on the same day announced that the Kwantung Administration had been reorganized as the "Port Arthur-Dairen Executive Administration" and that a CCP member has been "elected" President. The Dairen CCP Secretary, addressing the conference, said "The Port Arthur area is occupied by Soviet troops according to the Sino-Soviet Treaty, and is a 'new democracy' liberated area. The political power in Port Arthur-Dairen is the same as that in the rest of the liberated areas in the whole country."

These developments signify that the CCP, with the connivance of the USSR, has assumed open responsibility for the administration of Dairen, proclaimed the Kwantung Peninsula a part of Communist China and gone on record as endorsing the USSR's treaty rights in that area. Following Soviet diplomatic recognition of the Government of China to be established by the CCP, the Chinese Communists will probably request the USSR to open Dairen as a free port, in accordance with the provisions of the 1945 Treaty, and the USSR may be expected to accede to that request.

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INDONESIA:

Republican restoration agreement reached--The tension which has existed for the past year since the breakdown of Dutch-Republican negotiations under the Renville Agreement has been relieved considerably by an informal agreement reached at Batavia on 7 May under the auspices of the UN Commission for Indonesia. Although the Dutch agreement to restore the Republican government to the entire residency of Jogjakarta represents a first important step in compliance with the 28 January Security Council resolution, wide differences still exist in the positions of both parties. Furthermore, before these major divergences can be discussed and settled at The Hague, the difficulties inherent in the restoration to Jogjakarta will have to be overcome.

"A"

The liberal policy currently being employed by the Dutch will force the Republicans to prove their contention that the Republic has sufficient popular support to maintain a stable government. It has been difficult to assess the extent of President Soekarno's and Premier Hatta's political authority since their December internment because of the fragmentation of Republican political organizations during the subsequent period. Initial reports, however, indicate that the Republican "Emergency Government" is prepared to accept the agreement and rejoin the regular Republican government. Any solid Republican opposition to the agreement is expected to come, instead, from extremist elements of both right and left groups who regard any type of agreement as collaboration with the Dutch. The few major Republican military units which are still intact after months of warfare against the Dutch will probably remain loyal to Soekarno and the Sultan of Jogjakarta who will issue most of the orders relating to the restoration of Republican authority at Jogjakarta.

PHILIPPINES:

Avelino loses Liberal Party leadership--On 7 May, three-fourths of the Liberal Party's National Committee voted to relieve Jose Avelino, Quirino's intra-party rival in the forthcoming presidential race of his job as Party chairman, replacing him with Eugenio Perez, Speaker of the House of Representatives and a Quirino follower. Avelino, who draws his following from sections of the central and southern Philippines, has scheduled a national convention of his Liberal Party faction for 12 May. The Quirino wing, which considers itself the legitimate Party and Avelino a deserter, is expected to hold its convention early in June. A resolution of the recent Governors' and Mayors' Convention, substantially supporting Quirino's quest for reelection, indicates that the President will have most of the old Liberal Party machine behind him.

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